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Structure of Soviet Assistance

We estimate that the gross value of Soviet economic and military assistance has fallen from its peak level of $31.7 billion in 1981 to $19.7 billion by year-end 1985 (see table 1). Of this amount, economic assistance dropped from $21.8 billion in 1981 to just $10 billion in 1985, primarily due to the reduction in implicit oil subsidies as the price charged by the USSR reached world levels in 1984. Most of the economic assistance currently goes to the less developed countries (LDCs), with Cuba and Vietnam receiving about $5.9 billion of the $8.7 going to the LDCs. We estimate Soviet military assistance to the LDCs (both Communist and non-Communist) at $9.7 billion in 1985--roughly the same level as in 1981 but down from the $12 billion annual average recorded in 1982-84 (see table 2). Taking into account payments made to Moscow for its support--particularly from the USSR's lucrative arms sales program--the net value of Soviet economic and military assistance was an estimated $14.2 billion in 1985 compared with $23.8 billion in 1981. [redacted] 25X1

The USSR uses economic and military assistance to support its allies and clients as well as to expand it presence and influence into the less developed countries (LDCs). Much of this assistance consists of traditional economic and military aid. This aid, which is primarily in the form of favorable Soviet credits to finance deliveries to the recipient countries,

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reflects an actual transfer of resources on a gross basis.[1] On the other hand, about 20 percent of estimated 1985 aid--even higher in previous years--was indirect, reflecting concessionary pricing policies in Soviet trade with other Communist countries. The resulting implicit subsidies--measured as the difference between Soviet prices and world prices--represent an opportunity cost to Moscow, i.e. the amount Moscow could have earned on its exports to or saved on its imports from these countries had world prices prevailed, rather than a direct transfer of resources.[2] It is, therefore, difficult to interpret what the real cost of this element of assistance to Moscow is.

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These various forms of aid bring benefits as well as incur costs for the USSR. The USSR's assistance programs not only serve Soviet political and strategic interests but also provide economic gains as well, especially with regard to non-Communist LDCs. In particular, the military assistance program has been a major export earner for Moscow, netting some $7-8 billion annually during the early 1980's, including $5-6 billion in hard currency. In addition, we estimate that LDC repayments for Soviet economic assistance has been $400-500 million annually since the late 1970s. Taking these elements out, we estimate the net cost to Moscow of its economic and military assistance

[1] In line with past practices, we include all military deliveries in our gross estimates of military assistance, regardless of whether any concessional elements are involved. 25X1

[2] This assumes that the recipient country could have increased their exports by the necessary amounts which may not be the case, particularly in the short run. 25X1

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programs in 1985 at $14.2 billion--($10.4 billion if trade subsidies were excluded (see table 3) [3]. [redacted] 25X1

<u>Economic Assistance to the LDCs</u>

By 1985 almost 90 percent of estimated Soviet economic assistance was given to the less developed countries. The current situation stands in sharp contrast to the distribution of Soviet aid in the late 1970s and early 1980s when 65-70 percent of aid went to Eastern Europe. Moscow's Communist LDC clients (Cuba, Vietnam, Mongolia, Laos, Kampuchea, and North Korea) were by far the largest recipients, receiving $7.3 billion in economic aid and subsidies in 1985. [redacted] 25X1

Overall, Moscow's approach to the Communist LDCs is to supply them with sufficient trade and aid to keep their economies viable. The assistance has generally been equally divided between economic aid and trade subsidies. Soviet economic aid consists mostly of trade credits to finance Soviet projects and cover trade surpluses with these countries. [redacted] 25X1
[redacted] credits for development projects carry terms of up to 25X1
25-year repayment, grace periods for as long as 10 years at interest rates of no more than 4 percent. Credits to cover any remaining ruble trade deficit call for repayment over 15-17 years, including a 5-year grace period, at zero percent interest. Moscow's other Communist clients, with the possible exception of North Korea, presumably receive similar terms. In

[3] In a true economic sense, the cost to Moscow of extending credits to other countries is the difference between the interest rate paid by the borrowing country and the rate of return those resources would generate if invested elsewhere. [redacted] 25X1

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addition, Cuba, Mongolia, and Vietnam have all had their debt payments to the USSR rescheduled and/or portions of their debt cancelled.[4] 25X1

Soviet aid to the non-Communist LDCs is not only relatively small but is much less generous than that received by the Communist LDCs. Most of the aid consists of credits which are generally tied to specific projects and very rarely are credits extended to cover commodities or trade deficits. Credits for most major projects generally carry terms of 10 to 12 years at 2- to 3-percent interest with grace periods of 1 to 3 years. The USSR has increasingly supplemented such credits with less generous trade credits, including terms of up to 10 years for repayment, downpayments of 15 percent, and interest rates of 4 to 8 percent. 25X1

This economic assistance program is designed, in part, to expand Soviet exports and meet domestic economic goals by assuring a steady supply of materials delivered from Soviet-built projects. In addition, repayments of Soviet credits reduce the annual transfer of resources to the non-Communist LDCs by at least 35 percent. We estimate that these repayments have been $400-500 million since the late 1970s. Because most of the LDC economic debt owed to Moscow--estimated at end-1985 at $5 billion--is owed by countries such as India, Syria, and Iraq which are economically more sound than many LDC debtors, and because repayment is often tied to the delivery of commodities

[4] In contrast, North Korea repayments have exceeded new drawings for most of the 1980s. 25X1

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produced in Soviet-built enterprises, the USSR is not likely to incur the additional costs of having to reschedule this debt.

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Military Assistance to the LDCs

The USSR's military sales program is a major tool for establishing a Soviet presence and expanding influence in the LDCs. In contrast to its economic aid program, the bulk of Moscow's military deliveries go to non-Communist LDCs. We estimate that exports of military equipment (including major weapons systems, spare parts, ordnance, and other support materials) exceeded $9 billion in 1982 and 1983. These deliveries fell to under $8 billion in 1985 largerly as a result of LDC financial problems [5]. The domestic cost of these exports is the resources used in their production. Until the early 1970s, much of the equipment that the USSR sold to the LDCs consisted of used items being retired from Soviet military forces. The cost to Moscow was represented by the resources necessary to overhaul, adapt, and ship the arms. Since then, however, competition in the world arms market has led the Soviets to export mostly new equipment, including in recent years some sales of sophisticated equipment that only recently had been introduced into the USSR's military forces. Moreover, the

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opportunity cost also has risen as the growth of Soviet machine-building capacity has lagged behind the increase in requirements for investment goods, consumer durables, and military hardware. [redacted] 25X1

At the same time the resource costs were rising, however, Moscow was eliminating most of the concessionary elements from the program and converting it into a money-making proposition. Prices were raised and by the late 1970s price discounts had largely disappeared from Moscow's military sales program. Although attractive credits and some discounts are still used to finance sales to Moscow's poorer arms customers, some of the largest purchasers such as Iraq, Libya, and Syria have been paying mostly in cash, or its equivalent, upon delivery. In addition, for spare parts and other follow-on, the Soviets generally demand cash and have not hesitated to pressure key client states like Libya, Syria, Angola, and Mozambique to make required payments. This approach to its arms sales earned the USSR $7-8 billion annually in the late 1970s and early 1980s, including $5-6 billion in hard currency. LDC financial problems, however, have reduced hard currency earning to $3-4 billion since 1982. These earnings help Moscow to purchase machinery and equipment, agricultural commodities, and other products from the West to help alleviate domestic bottlenecks and technological gaps. [redacted] 25X1

Furthermore, until 1982, net credits (new credits less repayments of principal and interest) extended to the LDCs to finance these exports have accounted for under 20 percent of

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total military exports. Because of financial problems encountered by some of Moscow's key customers, primarily Iraq and Syria, net credits have exceeded $3 billion since 1982, or about 35 percent of total military exports (on a c.i.f. basis). The military sales program has also generated a sizable LDC debt to the USSR, estimated at $24 billion at yearend 1985. Unlike the economic debt owed to the USSR by the non-Communist LDCs, a substantial portion of the military debt (perhaps as much as 50 percent) is owed by countries that may well be unable to make their payments on schedule--for example, Ethiopia, South Yemen, North Yemen, Tanzania, and Mozamibique. The USSR has already rescheduled the debt owed by many of these countries. 25X1

Soviet military deliveries to the Communist LDCs are on a much more generous basis. These deliveries--estimated at $1.4 billion in 1985--are designed to maintain the armed forces of these countries at a level of readiness and strength considered necessary by their Soviet benefactors.[6] To the best of our knowledge, most of this equipment is provided free of charge (with the exception of North Korea which receives only a small amount of these deliveries) or at most for only a nominal charge. 25X1

Aid to Eastern Europe

Unlike the Communist LDCs, the countries of Eastern Europe need little direct economic assistance to maintain or develop their economies; in fact many are more advanced than the USSR.

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Soviet assistance to Eastern Europe, therefore, has taken the form of easing the adjustment for these countries to a changing world price structure. This aid has fallen from a peak of $14 billion in 1981 to slightly over than $1 billion last year, as the price of Soviet oil exports reached world market levels. [redacted] 25X1

In addition to the price subsidies which will be discussed in more detail below, the USSR has permitted the East Europeans to run sizable trade deficits rather than insisting that trade be balanced, the situation which had existed prior to oil price rises in the early 1970s. This shift in trade policy was never intended to be permanent and khe overall deficit has fallen from $4.4 billion in 1981 to $1.3 billion in 1985. These deficits have been financed by Soviet credits. Although the terms of these credits are not known, they presumably carry low interest rates of about 2-4 percent and at least de facto grace periods of several years. The Soviets do, however, expect to be repaid and trade plans for 1986-1990 with these countries probably incorporate at least partial repayment for all countries except Poland. [redacted] 25X1

<u>Subsidies</u>

We measure subsidies as the difference between the price agreed to by the Soviets and the world market price. Furthermore, we have tried to limit our estimates of subsidies to commodities where the Soviets have knowingly set the price to differ from the world price. The purest form of Soviet price subsidies results from the preferential Soviet pricing on purchases of Cuban sugar and nickel, neither of which has any

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relationship to world market trends. Thus, while world prices for sugar were plunging, the price the Soviets paid the Cubans continued to climb to $0.50/lb by 1983. On the other hand, the oil price charged to most of the USSR's Communist trade partners is based on the average world price of the previous five years. This formula was designed to ease the adjustment to sharply higher prices and not as a Soviet concession to set prices permanently at variance with world prices. Consequently, as world prices stabalized and actually declined, the oil subsidy dropped from its peak of $11.7 billion to nothing in 1985. With the world price of oil now about 50 percent below the Soviet price, these countries will be paying a substantial subsidy to the USSR over the next several years. 25X1

Unlike other studies, our estimates of Soviet economic assistance to Eastern Europe exclude subsidies for machinery and equipment and other manufactured goods.[7] The argument for including such so called subsidies is that in order for the East European countries to sell such commodities on Western markets they would have to be discounted by an estimated 30-50 percent. Soviet trade with these countries is largely isolated from international competition and prices are negotiated between partners using world market prices as a guideline. There is no Soviet concession to pay prices higher than the norm within CEMA. In fact, generally poorer Soviet equipment is priced on

[7] Michael Marrese and Jan Vanous, Soviet Subsidization of Trade with Eastern Europe: A Soviet Persepctive, University of California, Institue of International Studies, Berkeley, Calif., May 1983.

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the same basis. Moreover, although unattractive to Westerners, most of these products are of better quality than available in the USSR and the machinery and equipment which is often based on Soviet designs is easier for the Soviets to absorb than more sophisticated Western equipment. Use of a theoretical Western analog price is, therefore, inappropriate in our view. 25X1

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Table 1

USSR: Estimated Economic Assistance

(billions $)

	1975	1980	1981	1982	1983	1984	1985
Total	4.9	18.8	21.8	17.0	11.6	10.7	10.0
Eastern Europe	2.6	12.5	14.1	9.0	3.8	2.4	1.3
Trade Surpluses	0.8	2.8	4.4	2.7	2.2	2.4	1.3
Oil Subsidies	1.8	9.7	9.7	6.3	1.6	0	0
Communist LDC	1.8	5.5	6.8	6.8	6.4	6.7	7.3
Economic Aid	0.8	2.3	3.3	3.0	3.2	3.1	3.5
Subsidies	1.0	3.2	3.5	3.8	3.2	3.6	3.8
Non-Communist LDCs	.5	.8	.9	1.2	1.4	1.6	1.4
of which							
Grants	neg.	.3	.2	.2	.3	.2	.2

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Table 2

USSR: Estimated Military Deliveries to the LDCs

(billions $)

	1975	1980	1981	1982	1983	1984	1985
Total	3.0	8.9	9.9	12.6	12.0	11.4	9.7
Communist LDCs[a]	2	1.9	1.5	2.1	1.6	1.6	1.4
Non-Communist LDCs[b]	2.8	7.0	8.4	10.5	10.4	9.8	8.3

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[b] Estimated from Soviet trade statistics and includes estimated shipping and grant aid.

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Table 3

USSR: Estimated Net Military and Economic Assistance[b]

(billion $)

	1975	1980	1981	1982	1983	1984	1985
Total	5.4	21.5	23.8	21.1	16.0	15.5	14.2
Military	.7	2.9	2.4	4.5	5.0	5.4	4.7
Economic Aid	1.8	5.5	8.1	6.4	6.2	6.5	5.7
Subsidies	2.9	13.1	13.3	10.2	4.8	3.6	3.8

[b] These estimates are the sum of the totals from tables 1 and 2 less estimated payments (cash transactions plus principal and interest payments on credits).

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